

Direct Testimony
of
Peter Lazare

Rates Department
Financial Analysis Division
Illinois Commerce Commission

Northern Hills Water Company

Docket No. 03-0402

August 28, 2003

1

2 **Introduction**

3

4 **Q. Please state your name and business address.**

5 A. My name is Peter Lazare. My business address is 527 East Capitol Avenue,
6 Springfield, Illinois 62701.

7

8 **Q. What is your present position?**

9 A. I am a Senior Economic Analyst with the Illinois Commerce Commission
10 ("Commission"). I work in the Financial Analysis Division on rate design and
11 cost-of-service issues.

12

13 **Q. What is your experience in the regulatory field?**

14 A. My experience includes eleven years of employment at the Commission where I
15 have provided testimony and performed related ratemaking tasks. My testimony
16 has addressed cost-of-service, rate design, load forecasting and demand-side
17 management issues that concern both electric and gas utilities.

18

19 Previously, I served as a Research Associate with the Tellus Institute, an energy
20 and environmental consulting firm in Boston, Massachusetts. I also spent two
21 years with the Minnesota Department of Public Service as a Senior Rate Analyst,
22 addressing rate design issues and evaluating utility-sponsored energy
23 conservation programs.

24

25 **Q. Please discuss your educational background.**

26 A. I received a B.A. in Economics and History from the University of Wisconsin and
27 an M.A. in Economics from the University of Illinois at Springfield in 1996.

28

29 **Q. What is the focus of your testimony in this case?**

30 A. I focus on cost of service and rate design issues related to Northern Hills Water &
31 Sewer Company's ("Northern Hills" or "Company") filing for a general increase in
32 rates. I present testimony and exhibits concerning water and sewer rate design
33 issues. I also testify to the proposed test year billing units, as well as, proposed
34 miscellaneous tariff charges.

35

36 **Q. Are you addressing any revenue requirement issues for the Company in
37 this proceeding?**

38 A. No, I focus my review solely on the proposed tariffs (and underlying support) filed
39 by the Company to recover the revenue requirement deemed appropriate in this
40 proceeding.

41

42 **Q. Please explain how your testimony is organized.**

43 A. My testimony is split between water and sewer. I first examine the Company's
44 proposed rates and the accompanying support. Then, I review the Company's
45 proposed water proforma total revenues and discuss test year billing units. I then
46 discuss issues related to water rate design and miscellaneous water tariff charge

issues. Then I address proposed sewer proforma total revenues and test year billing units. I then discuss sewer rate design and miscellaneous sewer tariff issues.

Q. Have you attached any schedules to your testimony?

A. Yes, I have attached the following schedules:

Schedule 5.1- Recalculation of metered revenues

Schedule 5.2- Plant in Service and Expense accounts required for cost of service study

Schedule 5.3- Design of Current, Company-proposed and Staff-proposed rates

Schedule 5.4- Typical Bill Calculation

Schedule 5.5- Calculation of Sewer rates

Q. Please describe Northern Hills Water & Sewer Company.

A. Northern Hills is a wholly owned subsidiary of Utilities, Inc. ("UI"), which possesses 24 water and wastewater utilities in Illinois. Northern Hills is located approximately two miles north of Freeport in Harlem Township, Stephenson County. It provides water usage service to approximately 172 customers and sewer collection service to approximately 186 customers (Ross, Direct Testimony, p. 2).

Northern Hills, along with all of UI's water and wastewater systems is run by Water Service Corporation ("WSC") which provides management, administration, engineering, accounting, billing, data processing, and regulatory services for the utility systems. (Ross, Direct Testimony, p. 1)

WATER

Q. What are the Company's current metered rates for Northern Hills customers?

A. The Company's current rate structure consists of a Base monthly facilities charge of \$5.00 per month and a single block Gallonage Charge of \$2.84 for metered residential customers (Ross Direct Testimony, Schedule D).

Q. What changes does the Company propose to these rates?

A. The Company proposes to raise the current facilities charge by \$1.25 (or 25%) to \$6.25 per month and to increase the usage charge by 23 cents or 8.1% to \$3.07 per thousand gallons (Ross Direct Testimony, Schedule E).

Q. What is the first issue with respect to the Company's rates?

A. The issue concerns whether the Company has accurately calculated current and proposed revenues for this case. The Company calculates a total of \$41,109 in current revenues and \$46,185 in revenues under UI's proposed rates. (Ross Direct Testimony, Schedules D and E). To derive these revenues, the Company

multiplies the current and proposed customer and usage charges by the applicable billing and usage units.

Q. Has the Company accurately calculated current and proposed metered revenues?

A. Yes, it has. I base this answer on a recalculation of current and proposed revenues using the Staff cost of service study presented in Schedule 5.1. These recalculations closely mirror the Company's results, generating current revenues of \$41,110 and proposed revenues of \$46,180. Therefore, I conclude that the Company's calculations are reasonable.

Q. What test year water usage levels and billing units does the Company propose in this case?

A. The Company proposes to use year ending December 2002 usage levels and billing units for the test year (Ross Direct Testimony, p. 2).

Q. Do you have any adjustments to the Company's proposed proforma test year usage levels and billing units?

A. No, I have examined the Company's proposed usage levels and billing units and find them acceptable.

Q. Has the Company identified additional charges to customers for the Test Year?

115 A. Yes, the Company has identified the following additional charges for the Test
116 Year: \$102.33 in variable revenues associated with late payment charges; \$40 in
117 reconnection charges; a \$50 collection charge; \$120 in New Customer Charge
118 revenues (Company response to Staff Request WRJw 1.06) and \$107 in
119 Forfeited Discounts (Company response to Staff Request WRJw 1.03).

120
121 **Q. What is the relationship between Forfeited Discounts and Late Payment**
122 **fees?**

123 A. The Company has indicated through direct conversation that the forfeited
124 discount figure of \$107 represents the full amount of late payment fees collected
125 by the Company for the test year. In other words, this \$107 supersedes the
126 \$102.33 identified as late payment fees by the Company.

127
128 **Q. How have you therefore treated forfeited discounts in the calculation of**
129 **Test Year revenues?**

130 A. I have kept the Forfeited Discounts figure of \$107 and removed the \$102.33 Late
131 Payment Charge figure in the calculation of miscellaneous revenues.

132
133 **Q. Has the Company accurately accounted for these additional charges in its**
134 **revenue calculations?**

135 A. It has accounted for these charges accurately for current revenues. However,
136 there is one problem with its accounting for these charges with respect to
137 proposed revenues. That problem lies with variable revenues associated with late

138 payment charges, which are calculated as a percentage of customer bills (a 1.5
139 percent add-on). The Company identifies no increase in late payment revenues
140 from present to proposed rates even though they will rise if an increase is
141 granted in this case. I have corrected this problem by tying the increase in late
142 payment revenues to the revenue requirement increase granted in this case.

143
144 **Q. Has the Company allocated miscellaneous revenues between the Water**
145 **and Sewer utilities?**

146 A. Yes, the Company has allocated revenues between water and sewer based on a
147 combination of revenues and number of customers (Company Response to ICC
148 Data Request WRJs 1.03). This results in an allocation of \$167 in miscellaneous
149 revenues to sewer and \$150 to water. I have accepted the Company's allocation
150 methodology but increased the levels of miscellaneous revenues allocated to
151 both water and sewer to recognize that Forfeited Discount revenues vary directly
152 with the size of customer bills and therefore will rise if the Company is granted a
153 rate increase.

154
155 **Q. With respect to the Company's metered rates, what support does it provide**
156 **for its proposed charges?**

157 A. The support is minimal. The only explanation for the proposed rates is provided
158 in response to Staff data request WRJw 1.07 where the Company states that
159 once revenues were determined the regulatory department attempted to devise

reasonable base and usage charges. There is no attempt to justify the proposed rates on a cost basis.

Q. Does this lack of cost support present a problem?

A. Yes. The Commission has a longstanding objective of basing rates on costs. The lack of a cost foundation means that the Company's proposals fall short of this objective.

Q. How would Staff normally address the Company's failure to base its proposed rates on costs?

A. The normal response would be for Staff to develop an alternative cost of service study to use as a foundation for deriving cost-based rates

Q. Is such an approach possible in this proceeding?

A. No, it is not.

Q. Please explain.

A. The Company has provided insufficient data to develop cost of service study for this case. Staff's water COS study requires detailed cost and plant information in order to generate rates that are considered cost based. To secure that information, Staff sent a data request to the Company (WRJ 1.08) that identified specific categories, which would enable Staff to perform a COS study. The Company did respond to Staff's data request by providing information, but the

information was not broken down in an appropriate manner. (See the attached Schedule 5.02).

For example, the Staff Study needs to identify the costs associated with billing in order to determine the appropriate levels of customer charges. To determine that figure, Staff asked the Company to identify the level of Customer Account expenses. The Company stated in response that it incurs no Customer Accounts expenses. That clearly is not possible because the Company incurs expenses such as postage, paper, labor and related costs in maintaining customer accounts. To accept the Company number would clearly undermine the accuracy of Staff's cost of service study. However, there is no support on the record for using an alternative Customer Accounts figure. This lack of data thereby undermines the effort to develop a cost of service study for the Company.

Additional questions arise concerning other account data provided by the Company for Staff's cost of service study. The Company identified \$299,623 of Plant in Service costs associated with services. However, it did not attribute any Operation and Maintenance expenses to those services. This unrealistically assumes that a significant component does not require any additional expenditure to be operated or maintained. In addition, no expenses were identified for Transmission and Distribution related supervision, hydrants, and storage. While it is possible that the Company may not have expended costs in

some of these categories since the last rate case, the possibility of no expenditures in all the categories mentioned is quite low.

The more likely explanation is that the Company does not have the kind of reliable, specific information necessary to perform a cost of service study. This conclusion is supported by a phone conversation with Company witness Ross who indicated that the Company does not keep the detailed type of records Staff needs for its COS study.

Q. What alternative methodology do you propose to design rates?

A. I propose to apply an across-the-board equal percentage increase to current rates to meet the revenue requirement proposed by Staff Witness Hathhorn.

Q. What specific charges for metered service have you developed based on your across-the-board approach?

A. I have developed the set of charges presented in Schedule 5.3. These recommended increases were based on applying an equal percentage increase to existing charges to produce the revenue requirement proposed by Staff Witness Hathhorn net of the revenues produced by miscellaneous charges.

Q. What is the justification for your proposed approach?

A. It is justified by the lack of accurate data to develop a cost-based alternative. As previously noted, the Company has failed to provide the necessary information to

228 develop a cost of service study for this case. Thus, there is no cost foundation for
229 increasing one charge more or less than another. In the absence of such
230 support, the most equitable approach is to increase all charges on an equal
231 percentage basis which is my proposal in this case.

232
233 **Q. Do you have any recommendations to the Commission to improve the**
234 **quality of the cost data provided by the Company in future rate cases?**

235 A. Yes, I recommend that the Commission direct the Company to provide reliable
236 and accurate data that conforms to the categories of costs presented in Schedule
237 5.2. This cost data is essential because it represents the minimum level of cost
238 detail necessary to prepare a cost of service study. Furthermore, in developing
239 this cost data, the Company should be directed to show how all costs incurred on
240 a system-wide basis are allocated to each individual water company.

241
242 **Q. Do you have any further recommendation to the Commission concerning**
243 **future UI proceedings?**

244 A. Yes, I recommend that the Commission not limit this directive to Northern Hills
245 only, but rather require UI to provide more complete, accurate cost data for all
246 future rate cases by any of its Illinois affiliates. Staff has found that cost data
247 problems are not limited to a single utility. Therefore, it is essential that UI be
248 required to adopt a company-wide policy of upgrading its cost information.

249
250 **Q. Did you prepare a typical bill comparison?**

251 A. Yes, I did. It is attached as ICC Staff Exhibit 5.0, Schedule 5.4.

252

253 **Q. If the Commission determines a revenue requirement for the water portion**
254 **of Northern Hills, other than that recommended by Staff, how do you**
255 **recommend the rates be adjusted?**

256 A. I recommend that metered rates be adjusted on an equal percentage basis to
257 produce the revenues adopted by the Commission in this proceeding. That would
258 be consistent with Staff's overall rate design approach of raising rates on an
259 equal percentage basis.

260

261 **SEWER**

262

263 **Q. Did you review the Company's exhibits, workpapers, and data request**
264 **responses concerning present and proposed sewer revenues?**

265 A. Yes, I did.

266

267 **Q. Do you have any adjustments to the Company's present and proposed**
268 **revenues because of your review?**

269 A. No, I do not.

270

271 **Q. What test year sewer usage levels and billing units is the Company**
272 **proposing to use in this case?**

273 A. The Company is proposing to use year ending December 2002 usage levels and
274 billing units for the test year. (Ross Direct Testimony, p. 2)

275

276 **Q. Do you have any adjustments to the Company's proposed proforma test**
277 **year sewer usage levels and billing units?**

278 A. No.

279

280 **Q. Please explain the Company's present rate structure.**

281 A. The Company's present rate structure consists of a flat monthly facilities charge.
282 (ILL. C.C. No. 2, Third Revised Sheet No. 1) The Company's present and
283 proposed charges under the current rate structure can be found on Schedule 5.5.

284

285 **Q. Do you support the Company's present rate structure?**

286 A. Yes, I do.

287

288 **Q. Do you agree with the Company's proposed charges?**

289 A. No, I do not.

290

291 **Q. Please explain why you do not support the Company's proposed charges.**

292 A. The Company's proposed rates are not based on Staff's proposed revenue
293 requirement.

294

295 **Q. Did you or the Company perform a sewer COS study?**

296 A. The Company did not perform a sewer COS and Staff also did not perform a
297 sewer COS. Staff does not currently have a sewer COS study.

298

299 **Q. What charge are you recommending and how did you determine the**
300 **charge?**

301 A. My proposed flat rate facilities charge is also shown on Schedule 5.5. My rate
302 was determined by dividing Staff's proposed revenue requirement by the number
303 of customer's bills occurring in the test year.

304

305 **Q. If the Commission determines a revenue requirement for the sewer portion**
306 **of Northern Hills, other than that recommended by Staff, how do you**
307 **recommend the rates be adjusted?**

308 A. I recommend that the final revenue requirement should be divided by the number
309 of customer's bills occurring in the test year, as described above.

310

311 **Q. Please summarize your recommendations in this proceeding.**

312 A. I recommend the following:

313 1. The Commission order the Company file new Rate tariffs within ten (10)
314 days of the Commission order, attached to Company witness Ross' direct
315 testimony, with an effective date of not less than ten (10) business days
316 after the date of filing, for service rendered on and after their effective
317 date, with individual tariff sheets to be corrected within that time period if
318 necessary.

319 2. The Commission order the Company to provide reliable and accurate data
320 that conforms to the categories of costs presented in ICC Staff Schedule

321 5.2, and that UI be required to adopt a company-wide policy of upgrading
322 its cost information.

323

324 **Q. Does this conclude your direct testimony?**

325 **A. Yes, it does.**

RECALCULATION OF METERED REVENUES

	Company Present			Company Proposed		
	Billing Units	Rate	Revenue	Billing Units	Rate	Revenue
FACILITIES CHARGES						
5/8"	2,062	\$5.00	\$10,310	2,062	\$6.25	\$12,888
3/4"		\$7.00	\$0		\$9.10	
1"		\$8.65	\$0		\$11.25	
1.5"		\$12.40	\$0		\$16.10	
2.0"		\$17.15	\$0		\$22.50	\$0
3.0"		\$27.25	\$0		\$35.45	
4.0"		\$41.80	\$0		\$54.35	
SUBTOTAL			\$10,310			\$12,888
GALLONAGE CHARGES						
Metered	10844.549	\$2.84	\$30,799	10844.549	\$3.07	\$33,293
SUBTOTAL FACILITIES AND GALLONAGE			\$41,109			\$46,180

	PLANT IN SERVICE
INTANGIBLE PLANT	
SOURCE OF SUPPLY	
PUMPING PLANT	
WATER TREATMENT PLANT	
TRANSMISSION AND DISTRIBUTION	
Mains	
Meters	
Services	
Hydrants	
Storage	
GENERAL PLANT	
TOTAL PLANT IN SERVICE	

	O & M EXPENSES
SOURCE OF SUPPLY	
PUMPING EXPENSES	
Electrical	
Other	
WATER TREATMENT EXPENSE	
Chemicals	
Other	
TRANSMISSION AND DISTRIBUTION	
Supervision	
Mains	
Storage/Structures	
Hydrants	
Meters	
Services	
Misc, Rents, Other Plant	
CUSTOMER ACCOUNTS EXPENSE	
Remainder excl. uncol.	
SALES EXPENSES	
ADMINISTRATIVE AND GENERAL	
Uncollectible	
SUBTOTAL OPER. & MAIN.	
RECONCILIATION	
TOTAL OPERATION & MAINTENANCE	
Depreciation	
Other Taxes	
Income Taxes	
Utility Operating Income	
TOTAL	

RATE DESIGN ANALYSIS

Docket No. 03-0402

ICC Staff Exhibit 5.0

Schedule 5.3

	Company Present			Company Proposed			% increase	Staff Proposed			% increase
	Billing Units	Rate	Revenue	Billing Units	Rate	Revenue	over Present	Billing Units	Rate	Revenue	over Present
FACILITIES CHARGES											
5/8"	2,062	\$5.00	\$10,310	2,062	\$6.25	\$12,888	25.0%	2,062	\$5.44	\$11,217	8.8%
SUBTOTAL			\$10,310			\$12,888	25.0%			\$11,217	8.8%
GALLONAGE CHARGES											
Metered	10844.549	\$2.84	\$30,799	10844.549	\$3.07	\$33,293	8.1%	10844.549	\$3.10	\$33,618	9.2%
SUBTOTAL FACILITIES AND GALLONAGE			\$41,109			\$46,180	12.3%			\$44,835	9.1%
OTHER REVENUE											
Late Payment Fees			\$50			\$50	0.0%			\$55	9.0%
New Customer Charge			\$57			\$57	0.0%			\$57	0.0%
Misc. Service Revenues			\$0			\$0				\$0	
Uncollectible Accounts			\$0			\$0				\$0	
Reconnection Fee			\$18			\$18	0.0%			\$18	0.0%
Collection Charge			\$24			\$24	0.0%			\$24	0.0%
OTHER REVENUES SUBTOTAL			\$150			\$150	0.0%			\$154	3.0%
TOTAL OPERATING REVENUE			\$41,258	\$46,330			12.3%	\$44,990			9.0%

**NORTHERN HILLS UTILITY COMPANY
TYPICAL RESIDENTIAL BILL COMPARISON**

Docket No. 03-0402
ICC Staff Exhibit 5.0
Schedule 5.4

LINE NO.			CURRENT	COMPANY PROPOSED	STAFF PROPOSED
1		FACILITIES CHARGE	\$5.00	\$6.25	\$5.44
2		GALLONAGE CHARGE (PER 1,000 GALLONS)	\$2.84	\$3.07	\$3.10

	USAGE 1,000 GALLONS (A)	CURRENT MONTHLY BILL (B)	COMPANY PROPOSED MONTHLY BILL (C)	DOLLAR INCREASE (D)	PERCENT INCREASE (E)	STAFF PROPOSED MONTHLY BILL (F)	DOLLAR INCREASE (G)	PERCENT INCREASE (F)
3	1	\$7.84	\$9.32	\$1.48	18.88%	\$8.54	\$0.70	8.93%
4*	2	\$10.68	\$12.39	\$1.71	16.01%	\$11.64	\$0.96	8.99%
5	3	\$13.52	\$15.46	\$1.94	14.35%	\$14.74	\$1.22	9.02%
6	6	\$22.04	\$24.67	\$2.63	11.93%	\$24.04	\$2.00	9.07%
7	9	\$30.56	\$33.88	\$3.32	10.86%	\$33.34	\$2.78	9.10%

Notes:

* Typical monthly residential usage

SEWER RATE DESIGN ANALYSIS

	Current		Company Proposed				Staff Proposed		
	Units	Rate	Revenue	Rate	Revenue	% Increase	Rate	Revenue	% Increase
Base Rates	2,206	21.23	46,833	27.19	59,981	28.1%	26.88	59,297	26.6%
Late Payment Fees			57		57			66	
New Customer Charge			62		62			62	
Misc. Service Revenues									
Uncollectible Accounts									
Reconnection Fee			21		21			21	
Collection Charge			27		27			27	
OTHER REVENUES SUBTOTAL			167		167			176	
Total Sewer Revenues			47,167		60,315			59,648	26.5%